

Federal Court Sanctions a Patent-Holding Company and Its Attorneys for Bad-Faith Litigation

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John C. Paul
202.408.4109



D. Brian Kacedon
202.408.4301



Elizabeth A. Laughton
202.408.4288

Sometimes accused patent infringers face a painful dilemma: either pursue a costly litigation against a baseless complaint or pay a nuisance settlement. A recent case in the Federal Circuit may help curtail these baseless infringement actions, for the court sanctioned both the plaintiff and its attorneys for engaging in bad-faith litigation.

Section 285 of the Patent Act provides that, in "exceptional cases," a court may award reasonable attorneys' fees to the prevailing party in a patent litigation. Although rare, cases can be found "exceptional" based on inequitable conduct, litigation misconduct, bad-faith litigation, filing a frivolous suit, or willful infringement. Furthermore, Rule 11 of the Federal Rules of Civil Procedure—which applies to all federal civil litigation—allows courts to sanction attorneys who have made misrepresentations to the court.

In *Eon-Net LP v. Flagstar Bancorp.*, No. 09-1308 (Fed. Cir. July 29, 2011)¹, the Federal Circuit affirmed an exceptional-case finding by the District Court for the Western District of Washington as well as that court's imposition of Rule 11 sanctions against plaintiff Eon-Net LP; its attorneys, Zimmerman & Levi, L.L.P.; and the law firm's principal, Jean-Marc Zimmerman.

Background

Eon-Net sued Flagstar Bancorp in 2005, eventually asserting three patents that share a common specification and form a part of a larger patent portfolio. The patents relate to systems and methods for inputting information from a "hard copy" document by scanning, storing portions of the inputted document information in memory, and formatting the stored document information for use by a computer program, thus effecting a paperless office. Eon-Net, a patent-holding company, and Zimmerman had filed over 100 lawsuits asserting infringement of this patent portfolio, most ending in quick and inexpensive settlements far below the cost of litigation.

Eon-Net alleged that the processing of information entered by customers on Flagstar's website infringed the patents. Flagstar asked

the court to render a summary judgment of noninfringement. In addition, Flagstar asked the court for Rule 11 sanctions because of Eon-Net's failure to investigate or identify allegedly infringing products and because Eon-Net asserted baseless infringement claims. The court granted the motions and assessed attorneys' fees and costs against Eon-Net and Zimmerman.

Eon-Net and Zimmerman appealed to the Federal Circuit. In 2007, that court sent the case back to the lower court "because the district court failed to afford Eon-Net notice and the opportunity to present its infringement and claim construction arguments during the briefing on the motions." In the lower court, Eon-Net lost its arguments on claim construction and then stipulated to noninfringement. Flagstar then asked for attorneys' fees under § 285. The lower court, concluding that this was an "exceptional case," granted the motion. Flagstar also renewed its motion for Rule 11 sanctions, which the district court granted. The court also awarded attorneys' fees and costs under Rule 11 and under § 285. The court ruled that Eon-Net engaged in litigation misconduct and filed a baseless infringement action "in bad faith for an improper purpose."

Eon-Net and Zimmerman then appealed again, this time contesting the Rule 11 sanctions and the lower court's finding that the case was "exceptional" under § 285.

The *Eon-Net* Decision

The Federal Circuit reviewed the lower court's finding that this case was "exceptional." The court emphasized Eon-Net's many instances of litigation misconduct, including destruction of relevant documents, intentional failure to create a document-retention plan, "lack of regard for the judicial system," and improper litigation tactics. Thus, according to the Federal Circuit, Eon-Net failed to show that the lower court's findings on litigation misconduct and baseless infringement allegations were clearly erroneous.

The Federal Circuit also upheld the lower court's finding that Eon-Net filed the lawsuit in bad faith and for an improper purpose. The court recounted Eon-Net's extensive history of filing "[m]eritless cases like this one," and "exploiting the high cost to defend complex litigation to extract a nuisance value settlement." Though "it is not improper for a patentee to vigorously enforce its patent rights or offer standard licensing terms," the Federal Circuit observed that "the appetite for licensing revenue cannot overpower a litigant's and its counsel's obligation to file cases reasonably based in law and fact and to litigate those cases in good faith." As such, the Federal Circuit affirmed the lower court's exceptional-case finding.

Regarding the district court's imposition of Rule 11 sanctions, the Federal Circuit observed that in order to impose sanctions, the district court must determine that the complaint is legally or factually baseless from an objective perspective and that the attorney failed to conduct a reasonable and competent inquiry before filing the complaint. According to the court, "A reasonable pre-suit investigation" requires more than comparing the potential defendant's website and publicly available source code to each claim limitation and generating a claim chart, as Zimmerman did here. Rather, "counsel [must] perform an objective evaluation of the claim terms when reading those terms on the accused device." The Federal Circuit cautioned against indiscriminately following the directions of one's client, noting that "an attorney, in addition to his obligation to his client, also has an obligation to the court and should not blindly follow the client's interests if not supported by law and facts." For the reasons described above, the Federal Circuit concluded that "Eon-Net has failed to meet its high burden to show that the district court abused its discretion in imposing Rule 11 sanctions."

Strategy and Conclusion

Before bringing suit, an attorney must conduct a reasonable pre-suit investigation. In cases alleging patent infringement, such an investigation consists, in part, of an *objective evaluation* of the claim terms when comparing those terms with an accused device.

In *Eon-Net*, the Federal Circuit indicated its sympathy towards defendants facing baseless infringement contentions. Confronted with the possibility of a lengthy and expensive court battle, defendants often choose settlement for a sum much less than what they would have to spend to defend the suit. Plaintiffs who exploit this economic reality subject themselves to a finding of bad faith and expose themselves to substantial penalties in the form of attorneys' fees and costs under section 285 as well as Rule 11 sanctions.

Endnotes

¹The *Eon-Net* decision: <http://www.cafc.uscourts.gov/images/stories/opinions-orders/09-1308.pdf>

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